SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 574

PIEDMONT COTTON MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE PETITIONER

In its opinion in the *Virginian Hotel* case this Court did not advert to any considerations indicating that the result reached was necessary to prevent tax evasion or for any other substantive reason—and we submit that there are none. Nor did it suggest that there were any grounds for invoking principles of estoppel in that case. The opinion is devoted almost exclusively to a discussion of the words of the statute, viewed in the light of mechanics of tax administration, and the impression is created that the Court felt compelled by the statutory language to reach the result that it did. It is chiefly to that aspect of the question that this

supplemental brief is directed, since the practical implications of the decision are fully discussed in the petition.

The crux of the decision in the *Virginian Hotel* case is found in the following statements in the opinion:

> "'Allowed' connotes a grant . . . Deductions stand if the Commissioner takes no steps to challenge them . . . If the deductions are not challenged, they certainly are 'allowed' since tax liability is then determined on the basis of the returns . . ." (319 U. S. 523, at p. 527)

These conclusions reflect a serious lack of comprehension of the manner in which our tax system operates with respect to deductions. In speaking of a "grant" and of the Commissioner's taking no steps to "challenge" deductions, the Court must have assumed that the Commissioner had a means of "challenging" the deduction and refusing the "grant". Otherwise the Court could not have attributed any significance to the Commissioner's failure to "challenge" the deduction. In so assuming, however, the Court was mistaken, and this mistake produced the erroneous decision and opinion.

In fact, there is no procedure by which the Commissioner can effectively "challenge" a deduction which does not affect taxable income.[1] There is nothing he can do about an excessive depreciation deduction on a taxpayer's return unless disallowance would produce taxable net income. Thus, suppose that the gross income and the allowable deductions of a taxpayer for the year 1935 result in a loss of $10,000 before any deduction for depreciation; that the proper depreciation deduction for the year is $5,000, making the true loss $15,000; and that in filing its income tax return the taxpayer claims depreciation of $20,000 and shows a loss of $30,000. Even if the Commissioner made a thor-

[1] See footnote 9, petition for certiorari.

ough investigation of the return (which he would rarely, if ever, do in such a case) and concluded that the depreciation claimed was excessive, there would be no way in which he could "disallow" it. He would have no duty to act, and no authority to act, since no action which he might take would affect tax liability for the year. Any action which the Commissioner might purport to take would be wholly gratuitous, and the taxpayer could properly ignore it. Indeed, there would be no way in which the taxpayer could contest it even if he wanted to.

If the excessive deduction had any tax effect, the Commissioner could, and presumably would, disallow it, and machinery is provided for the taxpayer to resist and for the Commissioner to press his challenge. The taxpayer could argue the correctness of the deduction before several administrative bodies and could, in addition, seek judicial relief. The Commissioner could oppose the taxpayer at each stage of the controversy. Under those circumstances, there would be some significance to the Commissioner's failure to do what he had the authority and duty to do. Then his failure to challenge within the applicable period of limitation might, with some reason, be deemed an "allowance".[2]

Where, however, as in this case, the error in depreciation deduction makes no difference taxwise, can any more absurd waste of time be imagined than a futile attempt by the Commissioner to "challenge" the depreciation figures? Suppose the Commissioner (or the Secretary of Agriculture or the tax professor at some well-known law school, each of whom has just as much authority as the Commissioner in this respect) wrote the taxpayer and in-

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[2] Similarly, if the excessive deduction affected the amount of a loss carry-over to a subsequent year, the Commissioner would have authority to challenge the deduction in computing the tax liability for the later year, and his failure to challenge might reasonably be deemed an "allowance".

formed him that the figures were too high and would have to be reduced. If the taxpayer desired to contest the Commissioner's determination on the merits, he would find himself unable to obtain a hearing. The taxpayer would be well within his rights, however, if he replied as follows:

> Dear Mr. Commissioner:
>
> Your letter has been received. If you can show that I owe additional taxes, I shall be glad to pay them. Otherwise I shall thank you to mind your own business, and not to bother me with matters over which you have no jurisdiction.
>
> Sincerely,
>
> JOHN TAXPAYER.

If the taxpayer did so reply, there would be absolutely nothing that the Commissioner could do about it.

In such a case, it is utterly absurd to say that the failure of the Commissioner to do something which he has no authority to do anyway constitutes an "allowance". Laws are supposed to have some relation to common sense. It would indeed be a mockery of common sense to attribute any significance to the Commissioner's failure to exercise an authority which he doesn't have.

This Court could not have construed the word "allowed" as depending on the Commissioner's failure to "challenge" unless it had erroneously assumed that there was some effective way in which he could "challenge". Therefore, we respectfully submit that the Court should grant this petition for certiorari in order to correct its manifest error in the *Virginian Hotel* case.

Respectfully submitted,

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